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THE RECENT FINACIAL GROWTH OF ISLAMIC BANKS AND THEIR FULFILLMENT OF MAQASID AL-SHARIAH

GAP ANALYSIS

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Accounting for Islamic Financial Transactions [FN5103]

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ABSTARCT: Initially conceived in response to a faith-based logic of conforming to the principles of shariah in all spheres of life, the astounding growth of Islamic finance industry can be judged by the rapid pace at which the Islamic financial institutions (IFIs) are evolving around the world, where they co-exsist with a parallel system of conventional financial service. Growing at a rate of 10-15 percent per annum in the last decade, today the Islamic financial industry comprises of a range of financial institutions, including banks, non-banks finance companies, venture capital firms, insurance companies, mutual funds etc. However in the mist of all this boom one must not forget the real foundational purpose of these Islamic financial institutions and must relate to the fact that how much this recent growth is in line, based and driven by their foundational purposes i.e. MAQASID AL-SHARIAH. This study focuses exactly on this aspect and hence comes up with some meticulous analysis to assess the gap between this pomped financial growth and its compatibility with maqasid al-shariah by providing a litmus test for judgemental philosophies and hence in a niche effort to locate the gap between the two.

1.0.INTRODUCTION

As opposed to the image of conventional Anglo-American accounting as a neutral, value-free and objective technical activity, it was argued that accounting affects and is affected by society in a complex intertwining relationship.

Conventional accounting was shown to have certain underlying philosophical assumptions, which were the outcome of the Western worldview, values and social and economic values. These values, the result of the historical evolution of European civilisation, which went through several stages of development, were shown to be different from that of Islamic civilisation. It was shown that while the Western worldview is a mainly materialist worldview with secularism, democracy, consumerism, utilitarianism as its core values, the Islamic values present a dual-world view of trusteeship of God's resources and accountability here and in the hereafter. This worldview affects Islamic economic objectives and norms which is aimed at pleasing God through obedience to the Shari'ah in all aspects of life.

The basic difference was due to the Islamic teaching of Tawhid or Oneness (Unity) not only of God but also of creation and the practical consequence of this teaching is the unity of the state and mosque as opposed to the secularist thrust in the West.

A comparison of the Islamic world-view and values with that of Islam showed significant differences. For example, the strong belief of accountability in the hereafter had implications for the definition of welfare and success. Success in the West is mainly measured in terms of material possessions whereas an Islamic world-view would include material progress and good deeds undertaken. God's pleasure takes the place of (or at least conditions) the utilitarianism of modern economic theory. Further the prohibition of interest, gambling, alcohol and aleatory contracts in Islam, has major economic and accounting implications. Interest bearing securities are prohibited, hence profit calculations, which preserves equity between stakeholders, become

much more important in Islamic accounting. Further calculation of Zakat (an Islamic religious tax) becomes an important issue which has further implication on the valuation system used in accounting.

The implications of these different world views on the economic behavioural codes and on both conventional accounting and Islamic accounting was postulated in terms of differences in the objectives, users, recognition, measurement and disclosure characteristics. Since the accounting-society interface means that worldview affects accounting and vice-versa through user behaviour, it was argued that the use of conventional accounting by Islamic organisations, especially established to achieve Islamic socio-economic objectives, may lead to inconsistent behaviour of Muslim users of accounting information. This may in turn lead to non-achievement of the objectives of Islamic organisations and in the long-term perversion of the organisations themselves into capitalistic organisations. Thus, the development of an alternative Islamic accounting system consistent with Islamic values was shown to be necessary.

2.0. INDUCING FACTORS

2.1.The Push factors: Why conventional accounting is inappropriate for Islamic organisations and users.

This study next investigated in detail the factors, which necessitated the development of an Islamic accounting system. I have grouped these factors into two categories; the push factors and the pull factors. The push factors are those that made the existing conventional accounting system inappropriate for Islamic organisations and users while the pull factors consists of those factors which provided the impetus for Islamic accounting.

The push factors, which rendered conventional accounting inappropriate for Islamic organisations and users, were shown to be its objectives, characteristics and consequences Specifically, the underlying assumptions, the economic environment and dysfunctional effects of decision-usefulness were examined together with problems of the definition of social welfare

which decision usefulness is supposed to obtain. It was shown that the developed capital market assumptions underlying the objective of conventional accounting (to provide cash-flow information to investors and creditors) may not be true of developing countries in general and Muslim countries in particular. Further, the definition of social welfare, which was supposed to result from the use of accounting information, was shown to have some problems in the context of an Islamic society. Specifically social welfare could not be measured only in material terms in an Islamic society, as the equation of material allocative efficiency to social welfare, seem to indicate. This could in fact lead to efficiency at the expense of equity and justice, which are cornerstones of Islamic society.

It was thought that the requirement to calculate Zakat and preserve equity between stakeholders made some conventional accounting principles such as historical cost and prudence (together with the historical cost profit model) inappropriate from an Islamic point of view. It was suggested that a modified form of realisable income might be more suitable for Islamic organisations.

In tandem with the concern of critical and social accountants, the damaging consequences of conventional accounting to the natural environment, social fabric (e.g. loss of employment, privatisation) and multinational companies' exploitation and inequitable wealth transfer from developing countries was also shown to be unacceptable from an Islamic perspective. Finally, the behavioural consequences at the micro level resulting from the use of conventional management accounting tools such as budgeting and performance evaluation was shown to be unIslamic. The use of these tools could lead to cheating, conflict between employees and managers, between employees and to a perversion of the social objectives of Islamic organisations to materialist ones.

2.2. Pull Factors 1: The theoretical imperative

The first category of 'pull factors' for Islamic accounting is explored here. It is

shown that a paradigm shift in epistemology is taking place in the Muslim world through the attempted Islamisation of Knowledge. This movement was seeking to reintegrate knowledge with revelation – a position anathema to Western academics resulting from their historical experience with Christianity. For the Muslim, however, the movement was 'back to original roots' as for the Muslim world, the present bifurcation of knowledge into secular and religious is an unacceptable deviation from an Islamic perspective. This was claimed to be one of the causes of the Muslim malady of poverty and deprivation, in which they find themselves, leading a schizophrenic dichotomous life inconsistent with their fundamental beliefs. Islamisations of knowledge seek to recast modern disciplines (especially those of the social sciences) in the light and the vision of Islamic values and worldview.

2.3. Pull Factors 2: The practical imperative

This study also reviewed the development of Islamic organisations and features of the Islamic Economic System, which constituted the theoretical basis of these institutions. In particular, the problem of the riba (interest) which is prohibited under Islamic Law but which forms the corner stone of capitalist financial institutions and markets, were discussed. It was shown, that although there were differences of opinion on the definition of riba even in Muslim circles, which tried to exclude commercial interest from the prohibition, the majority of Muslim scholars and masses consider all forms of interest, commercial or otherwise as prohibited. The various types of Islamic Organisations were discussed and it was shown that modern corporate form of organisation was allowed under Islam with the exception of debt capital and possible misgivings of limited liability. However, all Islamic organisations would have to follow the Shari'ah with the consequence that they could not operate in certain prohibited industries. These included alcohol, pornography conventional finance and gambling. Hence, all Islamic organisations are ethical investors although the criteria of what is ethical may be different in

Islam as compared to Western ethical investments. Further, it was shown that the profit maximisation model is not suitable for Islamic organisations as their objective tend to incorporate secular utility and ‘ritual utility’, the latter consisting of non-profit oriented social objectives intended to please God.

Various types of Islamic business and non-profit organisations were reviewed briefly. These included Zakat collection and distribution agencies, Awqafs (endowments), Islamic insurance companies and Islamic businesses. The objectives and operations of Islamic banks were reviewed in some detail. This review showed that the structure, objectives and operations of these Islamic organisations were somewhat different from their capitalistic counterparts. As such, their accounting requirements were somewhat different. For example, the operations, the nature of the financial instruments used by Islamic banks and the need to allocate profits between the banks and depositors, required different capital adequacy ratio regulations and different accounting standards and procedures. In addition, the ethical nature of these banks required different disclosure standards especially for non-financial disclosures.

3.0. Islamic Accountability, the objectives and characteristics of islamic accounting

Theory of Islamic accounting considers the ethical background of Islamic organisations and the objectives of Islamic economics under which Islamic business organisations operate. The attainment of falah (success and welfare), which included both economic and social attainments, was shown to be the objective of Islamic economics. These attainments would have to be accounted to God in the hereafter, in the Islamic perspective but it was recommended for Muslims to keep track of their actions in this life.

Consistent with this world-view and economic paradigm, it is defined and suggested that an “Islamic Accountability” framework would be more appropriate for Islamic accounting rather than “decision-usefulness” advocated for conventional accounting. As a matter of fact, i put like this. “An

Islamic accountability model, showing a dual accountability role for Islamic organisations (or accountants) – one to God (in the form of social accountability to society and stakeholders) and one to the contracted accountee".

Besides the primary objective of "Islamic accountability", there are also subsidiary objectives of Islamic accounting. These included the provision of information on **Shari'ah compliance**, the proper assessment and distribution of Zakat, the equitable and fair distribution of wealth generated by the organisation among its employees and other stakeholders and the promotion of a co-operative environment and solidarity.

Further it is also suggested that stakeholders other than shareholders might be as important if not more important as users of Islamic accounting information, in line with the Islamic concept of taklif' or "responsibility according to capacity". Since large corporation used more community resources, they would have to be accountable for them to the community.

Islamic accounting theory also considers the characteristics of Islamic accounting and proposed that it be holistic and integrative rather than restricted by the monetary measurement concept to "internalities" only. It was proposed that Islamic accounting should inform users on Shari'ah compliance and prohibited transactions, wealth distribution, internal employee/manager relationships and social and environmental impact of the accounting entity.

And last but not the least it notes the importance of income calculation in Islamic accounting as there would be an absence of interest-based instruments and a preponderance of Mudharaba and Musharaka (dormant and active partnerships respectively) contracts. Due to this and the wealth transfer implications of Zakat, it was suggested that the historical cost model should be replaced with a mixed valuation model using current valuation for stocks and fixed assets but separating the operational and holding gains.

So after going through all this how can we now summarize or define what

Islamic accounting is.

3.1.DEFINITION OF ISLAMIC ACCOUNTING:

As per Dr.Shahul Hameed Mohamed Ibrahim Islamic accounting is a vast terminology and to be precise it is used as a tool by the Islamic financial institutions i.e. Islamic banks to monitor and achieve their objectives (which are different from capitalist institutions) and will make decisions in a manner congruent with Islamic values to achieve **Maqasid-ul-Shariah** or **Shariah compliance.** After defining Islamic accounting it naturally becomes imperative for us to define and understand what those institutions which put it into practice are i.e. the Islamic banks.

3.2.DEFININATIONS OF ISLAMIC BANK

According to the board term of The International Association of Islamic Bank an Islamic
bank is defined as
“An Islamic Bank is a Banking company which implements a new banking concept in that it adheres strictly to the rulings of Islamic Shari’ah in the fields of finance and other dealings”.
However the term Islamic Bank may be defined in some different specific term according to the territorial anatomy of the country or region. Keeping in view the objective of Islamic bank, we can define Islamic bank as
“A banking institution which conducts all its operations conforms to Shari’ah, without
Involving itself and its clients in Riba (interest) in any way”.
The second definition incorporates the both aspects of banking and Shari’ah on an equal
Proportion, as Islamic bank has to fulfill two basic requirements. Firstly its operations must be based strictly on Islamic principles and secondly it must perform the functions of a sound banking. It is therefore indicative that the Islamic bank faces the technical constraints usually imposed on banks and is also subjects to the legal and ethical constraints provided by the Shari’ah.

Perhaps Ahmed A. El-Fouad in Meeting the Economic Needs of Society, gives the most comprehensive definition of Islamic bank as follows :

１. Multifunction banks, offering all the services rendered by commercial, merchant, investment and development banks, but on an interest-free basis;

２. They are international bank and they work and co-operate with the rest of the international banking community; and

３. They have social obligations towards the community they serve (exist). Each (bank)
has a Zakat (obligatory wealth tax from Islam) fund which offers financial assistance to
the poor and needy.

Therefore the performance of Islamic bank is evaluated not only in financial terms but also by the criterion that its profit should be justified Islamically. Hence the existence of a Shari'ah Advisory/Supervisory Board, which continuously examines the transaction of the Islamic bank, is prerequisite of Islamic bank. This essential feature differentiates the Islamic bank from the conventional bank.

From this definitions and from the literature above,we can sum it up with utmost easy and least doubt that Islamic accounting in Islamic banking is nothing but to achieve Human Falah i.e the **Shariah Compliance** or in a broad terminology **Maqasid al-Shariah.**

Before we indulge deep into out discussion, we need to understand what this Shariah Compliance is all about. According to Dr.Saiful Azhar Rosley there are four parameters or approaches of **Shariah Compliance.**

4.0. The four parameters/approaches are:

4.1. The *Aqad* Approach

In developing new Islamic financial products, *Shariah* principles have been applied as the litmus test of legality. In the conduct of innovation, Shariah scholars however tend to align Shariah principles around the parameters of contract ('*aqd*). In this way, the new product will received a *Shariah*

compliant status when it has fully complied with the requirement of the contract at hand. Hence, *halal* and *haram* of actions pertaining to using the financial instruments are fully determined by the legality of a contract (*al-aqd*).

In Arabic, *al-aqd*" literally means an obligation or a tie. It is an act of "putting a tie to a
bargain". The *Mejella* has defined contract as "the obligation and engagement of two
contracting parties with reference to a particular matter. Contract is a source of obligation and its faithful fulfilment is a duty in accordance with *Surah* 5, Verse 1 of the Qur'an: "Oh ye who believe, fulfill your undertaking" and then in another verse, the Holy Qur'an call upon believers to observe their engagement as they will be accounted for all their engagements. Surah 17, verse 34 reads:*"And fulfill every engagement (ahd) for every engagement will be inquired into (on the day of reckoning)"* The validity of contract rests on the fulfillment of the four principles of contract namely: 1) buyer and seller 2) price 3) subject matter 4) offer and acceptance. For an example, a valid subject matter means that firstly, it is pure (*mal-mutawawim*) and secondly, seller holds legal ownership of goods. Valid price means that price must be set on the spot and make known to the buyer. Valid buyer and seller mean they are rational (*aqil baliqh*) enough to conduct the trade so as to understand their respective roles and obligations. In other words, the elements of ambiguities (*gharar)* must be avoided in all contracts in Islamic law as its presence will cause defects to the contract. When *gharar* exists in the contract, it will cease to become valid and consequently receive no legal protection.

4.2. Accounting and Financial Reporting Approach

Based on our above discussions, accounting can be defined as the process of identifying, measuring and communicating economic information to permit informed judgement and decisions by users of the information.In Islam

accounting fall under the purview of *hisb* and part and parcel of the *al-hisbah* system. The purpose of financial statements or financial reporting is to provide information about the financial strength, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions. It serves to eliminate ambiguities (*gharar*) in financial contract through factual reporting of the said transaction. More importantly, financial reporting explained what exactly was transacted in the business dealings such that one is able to know whether, say, a transaction is a loan or a sale, whether a sale is a true one or not. This is important because accounting information is used by investors who make economic decisions by making predictions of future cash flows of company they invested in. For this reason, financial reporting should be understandable, relevant, reliable and comparable as laid by the International Financial Reporting Standard (IFRS). This is an Islamic imperative that all IFIs must subscribe to such that stakeholders can gauge its real value to society.

In financial accounting, a balance sheet or statement of financial position is a summary of a persons or organization's assets, liabilities and ownership equity on a specific date, such as the end of its financial year. A balance sheet is often described as a snapshot of a company's financial condition.

A company balance sheet has three parts: assets, liabilities and shareholders' equity. The main categories of assets are usually listed first and are followed by the liabilities. The difference between the assets and the liabilities is known as the net assets or the net worth of the company. According to the accounting equation, net worth must equal assets minus liabilities. The application of trading and commercial principles (*al-bay*) in Islamic banking requires banking firms to adhere to financial reporting standard whose purpose is to provide true information of business transactions. For example, when the transaction uses the contract of *ijarah* (leasing), then the leased asset must be reported in the balance sheet as fixed asset. The purchase of the leased asset is subject to tax whose

payment is recorded as operating expense in the income statement. Depreciation allowances are recorded as an expense, thus the company that took the leasing option can benefit from the tax allowances to improve the bottomline. *Al-Ijarah thumma al-bay (AITAB) ie* leasing with intention to own or buy, is currently a Shariah
complaint contract applied for car financing. As specified by the contract of *ijarah*, the leased asset should be recorded as fixed (*ijarah*) asset. But when AITAB operates under the conventional Hire-Purchase Act 1967, it (ie AITAB) is treated as a financing activity instead of a true lease as no recording of *ijarah* asset is evident in the balance sheet. In asset-financing such as *murabaha* or *al-bai-bithaman ajil* contract, the bank is expected to purchase the asset before making the sale. The principle that “one must not sell what one does not own” confirms that the bank must hold ownership of asset prior to sale and thus record it in the balance sheet. Such accounting treatment is an inevitable fact and any Islamic bank that failed this test is guilty of *riba* since it indicates that no true sale exists. Although bank may hold the asset for a few days or even hours, proper accounting must be uphold. Financial reporting can prove that a *bay al-enah* sale is not a true sale but only a fictitious one. Although the *aqad* approach says *bay al-enah* is valid (*sahih)*, but not actual sale ever took place since no recording of purchase is evident in the balance sheet. There seems to be a conflict between juristic validity and financial reporting. Such inconsistency suggests that the contract approach cannot stand alone anymore and must find supplementary devices to secure complete Shariah legitimacy.

4.3. Legal Documentation of Contract Approach

The *aqad* Approach primarily pays attention to the fulfillment of the pillars of contracts.
Indirectly, rights of contracting parties are defined and made explicit in contracts. The purpose of legal documentation is to provide security to contracting parties where their rights, obligations and responsibilities are

clearly spelt out in the terms of agreement or contract. The security enabled them to seek legal protection in case the outcome of the contract is not realized as agreed upon in the agreement. In Malaysia, consumers usually receive legal protection from three legal principles and provisions under:

1) Contractual law: A contract is a legally binding agreement between two parties by which each party undertakes specific obligations or enjoys specific rights of that agreement. In Malaysia, the Law of Sale of Goods 1957 and the Law of Hire-Purchase 1967 provides ample provisions for consumer protection such as passing the asset's title to the buyer.

2) Law of tort: The law of tort deals with liabilities of the seller. If the consumer suffers injury or harm from the goods sold (ie found to be defective and dangerous) the seller is liable to paydamages.

3) Regulatory (penal) statutes: These affect specific activities that directly or indirectly
affect the consumer. They serve to impose standards on goods, services or safety measures by prohibiting specific activities or requiring certain things to be satisfied. Some examples of regulatory statues in Malaysia are the Price Control Act 1946, Control Supplies Act 1961, Weight and Measure Act 1972, Trade Description Act 1972 and the Direct Sales Act 1993. Business malpractices (*tatfief*) can take various forms such as large business organization to monopolize production and kill the competition, misuse of trademarks and patents, sale of duplicate goods by unscrupulous traders, malpractices in direct sales, misrepresentation of cheap sales, misleading price indications, deceptive labeling of products, exploitation and malpractices in housing and real estate transactions. Since the Islamic banking business is no longer confined. to financial transactions alone but more importantly the conduct of buying and selling involving possessions and delivery of goods, it is now more exposed to moral hazards commonly evident in the retail and wholesale business. Thus, consumer protection is next in line to be seriously looked at in Islamic finance innovation. Consumer protection is a form of government regulation which protects the interests of

consumers. For example, a government may require businesses to disclose detailed information about products—particularly in areas where safety or public health is an issue, such as food. Consumer protection is linked to the idea of consumer rights (that consumers have various rights as consumers), and to the formation of consumer organizations which help consumers make better choices in spending.

Consumer protection law or consumer law is considered an area of public law that regulates private law relationships between individual consumers and the businesses that sell them goods and services. Consumer protection covers a wide range of topics including but not necessarily limited to product liability, privacy rights, unfair business practices, fraud, misrepresentation, and other consumer/business interactions. Such laws deal with bankruptcy, credit repair, debt repair, product safety, service contracts, bill collector regulation, pricing, utility turnoffs, consolidation and much more. There are many compelling reasons why consumer needs protection. Some major ones are as follows: Poor bargaining position, consumer safety, information gap and advertising practices. In order to protect the consumers from business malpractices and manipulation, they need to be informed about their rights. The International Organization of Consumer Union (IOCU) outlined eight rights of the consumer, such as 1. Right to adequate product information 2.Right to quality and safety of goods and services 3.Right to choose 4. Right to be heard 5. Right to get consumer education 6. Right to healthy environment 7.Right to redress The concept of right7 in Islam lies in the definition of '*huquq*, pl. of *haqq*. The word *haqq* meaning "something right, true, just, real"; *haqq* in its primary meaning is one of the names of Allah (s.w.t), and it occurs often in the Qur'an in this sense, as the opposite of *batil* (vain, false, unreal). A further meaning of *haqq* is "claim" or "right", as a legal obligation. Islamic Law distinguishes the *haqq* into two kinds: One; the rights relating to Allah (s.w.t), and the second; right relating to individuals. The rights relating to Allah are the rights which relate to

public interest. They are linked to Allah due to the seriousness of the rights and the
comprehensiveness of their benefit. The rights relating to individuals are those which are related to individual interest. Therefore, pardon and compromise is not permissible in the rights relating to Allah while in the rights relating to individual it is permissible.
Under Islamic Jurisprudence, *haqq* is defined as "the exclusive power over something, or a demand addressed to another party which the shari'ah has validated in order to realise a certain benefit". In Islamic finance, commerce right is confined to something that has monetary value *(qima maliyya*). The concept is confined to rights having monetary value which the law protects i.e. the right of maintenance for dependants, the right to demand wages for work done and the right to demand the delivery of object of the sale upon payment of its price. Such rights are personal and material, as they are designated in the law.

4.4 .THE MAQASID APPROACH-THE WHOLE SOME CONCEPT OF SHARIAH AND COMPLIANCE TO IT!

Shariah principles can best be understood from an angle it is destined for, namely the purposes and objectives of Islamic law (*maqasid al-Shariah*). This will prove more effective since it allows Islamic financial institutions to match their products and commercial viability more accurately to the demands of Islamic ethics and morality and hence justice (*'adl*). This is because the *maqasid* of *Shariah* serves to do two essential things, namely *tahsil*, i.e. the securing of benefit (*manfaah*) and *ibqa*, i.e. the repelling of harm or injury (*madarrah*) as directed by the Lawgiver. In this respect, innovation in Islamic finance and all endeavours to test the legality of a new product must readily comply with the purpose (*maqasid*) of the *Shariah*. Based on the above argument, it is worthy to examine what constitutes the *maqasid al-Shariah*. One purpose of the *Shariah* is the preservation and protection of the basic necessities (*daruriyat*) of man without which life would probably be filled with

anarchy and chaos and thus become meaningless. Basic necessities in Islamic law are religion (*Din*), Life (*Nafs*), Family (*Nasl*), Intellect ('*Aql*) and Property (*Mal*). For example, the prohibition on drinking wine (*khamr*) is based on two reasons. First, the intoxication effect will make one lose his senses. This prohibition therefore serves to repel the harm of losing one's senses. The second is the protection of the intellect which also means preservation of benefits.

In relation to the protection of property (*al-mal*), the prohibition of *riba* serves to repel the harm incurred by the payment of interest as it depletes one's property. Thus, by prohibiting *riba,* the harmful effects (*madarrah*) of poverty and widening of the income gap can be pre-empted. Likewise, the positive Quranic attitude towards trade and commercial activities (*al-bay'*) serves to secure the benefits of mutual help and equitable transactions ordinarily evident in the business environment. People engaging in business will take a natural path in dealing with risk and return as both move in a harmonious fashion. And by conducting *al-bay* and thus deriving benefits from it, it can make the business of money lending less profitable than trading.

The *maqasid* of *Shariah* will also assure that an Islamic financial institution will provide services that can repel the harm (*madarrah*) commonly found in the Western mode of financing. If the harm is still obvious in the new Islamic financing product, it must be eliminated at all cost. Otherwise, the product will not reflect the true ideals of Islam. For example, hedging against price volatility is an important ingredient in business today. Manufacturers who buy raw material as inputs are on the lookout to buy them at the cheapest cost possible. Some will buy forward, i.e. buy the commodity now to be delivered and paid for at a specific future date. The price is set on the spot on the day the contract is arranged. There are serious disagreements among *Shariah* scholars on this matter. Some say this kind of forward contract is permissible as it has fulfilled the requirements of a valid contract while others say the

contrary as the contract is akin to gambling (*maisir*) and therefore invites harm and injustice (*zulm*).

When the issue is examined from the contract (*‘aqd*) perspective alone, i.e. applying rules of contract in determining legality, it may discount the very purpose of the *Shariah* and hence unable to repel the harm it is initially intended to do. If it can be proven that forward contract is free from harm either from the gambling element or ambiguities (*gharar*), then it should prove beneficial to Islamic finance and hence be adopted by Islamic financial institutions. However, if it is found valid (*sahih*) from the '*aqd* perspective but has been shown to have adversely affected the general welfare, it shall then remain prohibited since it has failed to repel the harm, thus defeating the very purpose of the *Shariah.* Fulfilling the *maqasid Shariah* should therefore serves as the underlying principle of Islamic financial innovations as it safeguards rulings based on *fiqh* from moving into unwanted territory. The purpose (*maqasid*) of *Shariah* and the rulings on contracts should not conflict with each other. If it does, the *maqasid* shall stand above the rulings of contracts. This is because the former is based on the Divine Law while the latter is founded on human understanding (*fiqh*). In this manner, the legality of a financial contract is judged not only from the contract (*aqd*) aspect but equally important its economic and social impacts (i.e. benefits and disbenefits) to the general public. For example, if Islamic financial products are found to pull people to fall into debts and bankruptcy, how can we explain it as a worthy alternative to conventional financing? On the contrary Islamic products should enhance economic growth, reduce poverty and bring happiness to human beings.

The recent subprime crisis in the United States should be a lesson to Islamic banking. Sale of mortgage loan called for the issuance of CDOs by special purpose vehicle (SPV) companies. The securitization of loan receivables by the SPV is an issue in Islamic finance. While Shariah allows securitization of physical assets, it prohibits the sale *murabaha* receivables although Malaysia Shariah scholars had allowed this. Although subprime crises is not caused by

solely securitization but instead bad credit appraisal in loan origination, Islamic banks that runs on credit financing is still exposed to credit risk. In this way, the benefits and disbenefits of using products involving deferred payments such as *murabahah* should be examined in academic research so that the disbenefits of *murabahah* is proven substantially less than interest-bearing.So to sum it up this parameter of **Maqasid al-Shariah** after such meticulous scrutiny will lead and hence bring one to a conclusion that this approach to the Shariah compliance is actually what lays at the heart of the very foundations of it and hence provides with the right thrust and impetus directly or indirectly encompassing all the above parameters and blends them into a single tool,rather a touch stone of Shariah Compliance.

Now once we have deduced this wholesome approach to Shariah Compliance, lets us now use it as a LITMUS TEST for Islamic institutions i.e. the ISLAMIC BANKS.

Our test will be a double edged sword as a matter of fact it will not only test an Islamic bank's financial performance and thus the overall financial growth but simultaneously would try and see how much have they been steadfast in achieving MAQASID AL-SHARIAH in other words, how much Shariah Compliant they are along side their financial growth. We will then put them through a filter thereby to hold their overall rating by putting them into a FGMS MATRIX which will prove how much are these institutions are in line with their true foundations and goals of achieving MAQASID AL-SHARIAH and hence HUMAN FALAH.

THE REAL PICTURE

5.0. From utopia to reality

In responding to this moral economy strategy, the initial experience of IBF in Egypt in late 1960s was structured as a socially-oriented institution, aimed to provide credit to peasants, small businesses, and workers to overcome

financial exclusion and expand the ownership base of society.

However, despite such a novel origin, with the internationalisation and unprecedented growth in their assets base and financing since 1980s, the lives of Muslim individuals have not been significantly affected by such development of IBF, as the social dimension is limited to zakat and other non-systematic charitable activities, which negates systematic economic development.

It might be useful, therefore, to compare the realities against the aspirational worldview by deconstructing the practices of IBF through values the practitioners attach to IBF against the foundational values mentioned above. Speaking at the Islamic Finance Seminar held in London last year, Iqbal Khan, a leading contributor to the development of the sector, suggested the following values among the aims of IBF:

- Profit-and-loss (PLS) sharing and risk- sharing is preferred alongside creating more value addition to the economy;

- Community banking: serving communities, not markets;

- Responsible finance, as it builds systematic checks on financial providers; and restrains consumer indebtedness; ethical investment, and corporate social responsibility (CSR) initiatives;

- Alternative paradigm in terms of stability from linking financial services to the productive, real economy; and also it provides moral compass for capitalism;

- Fulfils aspirations in the sense it widens ownership base of society, and offers ‘success with authenticity’.

It is clear that these values fit into the aspirational values of Islamic moral economy-IME as well. A critical examination of these objectives, however, indicates that the reality is far from fulfilling these objectives.

Regarding preference towards equity-based PLS and risk-sharing financing over debt financing, data analysis, for instance, in the Malaysian IBF case depicts that the percentage share of musharakah declined from 1.4 per cent in 2000 to 0.2 per cent in 2006, while major modes of Islamic financing remain to be bai bithaman ajil (sale of goods on a deferred payment basis; another term used for such sales is bai mu'ajjal) and ijara wa iqtina (leasing and subsequent purchase) with 55.9 per cent and 25.2 per cent respectively in 2006. In addition, from 1984 to 2006, murabaha constituted 88.1 per cent of the mode of financing for Bank Islam Malaysia Berhad, and 67.3 per cent for Dubai Islamic Bank, while mudarabah and musharakah was about 1.7 per cent and 9.3 per cent respectively.

Moreover, in relation to social lending, the percentage of qard hasan (an interest-free loan for welfare purposes/short-term funding requirements) is at a negligible level in IBF sector. Taking into account that IME aims for equity financing for creating value addition in economic activity, the change towards debt-financing is rather meaningful, which indicates that IBF institutions have deviated from the economic development and social welfare objectives of IME. Thus, the promise of Islamic finance in relation to its performance failed to be realised in providing socio-economic development for the larger parts of the Muslim world and communities.

Data analysis also shows that long-term financing is not the norm, as most of the financing focuses on projects with maturities lasting less than a year. In addition, while developmental financing necessitates financing sectors such as agriculture and manufacturing, the majority of IBF is related to retail or trade financing. For instance, after the initial years, Islamic banks in Sudan

moved away from financing agriculture and industry using PLS schemes. Furthermore, instead of investing in value-added economic activity in the Muslim countries, there has been a tendency to invest the funds abroad. As a result, the value addition of IBF to the local economy has further declined, and the contribution of IBF for economic development through real economy has been rather elusive.

Regarding the community banking objective, experience shows that IBF has done little to contribute to capacity building in the communities. On the contrary, IBF has aimed at becoming part of the international financial markets and, despite the social expectations, IBF claims that it is not a charity, and that firms have to work under difficult competitive conditions. Clearly, this indicates profit maximisation as the aim, which negates the importance of societal responsibility.

As regards to responsible finance, there is no universally accepted regulatory body that systematically checks Islamic financial providers. The initiatives by AAOIFI (Accounting and Auditing Organisation for Islamic Financial Institutions) in Bahrain and IFSB (Islamic Financial Services Board) in Malaysia remain weak and are not generally adopted. To evidence this, a recent study demonstrates that a large number of Saudi Islamic finance practitioners, accountants and auditors, are largely unaware of AAOIFI standards.

Pertaining to fulfilling aspirations, IBF has not positively affected social capacity building and contributed to widening ownership, which could have been possible through venture capital or PLS type of investments. However, as discussed previously, these do not seem to be preferred by IBF.

As part of restraining consumer indebtedness, the data indicates that IBF institutions prefer to involve themselves in transactions, which are debt-

financing oriented, as they are more profitable. Thus, this aim remains unfulfilled.

Concerning ethical investments, restraining the investment areas does not necessarily make IBF ethical. Rather, it only implies that IBF fulfils its legal expectations, as screening of Islamic investment is part of Shari'ah. However, considering that ethicality includes being pro-active in regards to IBF, there is little indication that the industry is entirely ethical.
In terms of real economy consequences, the claim that IBF links financial services to the economy's productive side is not convincing, since IBF does not exhibit macroeconomic consequences. Particularly so, when considering the most preferred financing is debt financing as opposed to equity financing. It is, therefore, difficult to argue that IBF is related to the real economy beyond financing the retail markets. In addition, further involvement of IBF sector in debt-like financing, including tawaruq products (sale of a commodity to the customer by a bank on deferred payment at cost plus profit), clearly undermines the 'productive economic activity' discourse in Islamic economics.

The realities of financial markets, which prioritise economic incentives rather than religious behavioural norms, has thus forced IBF to become part of the international financial system by adopting the commercial banking model. In that predicament, IBF is described as heterogeneous financial products deprived of their value system as expected by IME. Under such circumstances, it is difficult to argue that IBF acts as a moral compass for capitalism, either. On the contrary, recent studies show that IBF has much to learn from conventional finance in terms of ethical and CSR financing issues.

As to locating the principles governing IBF in the Quran, indeed it reveals the importance of authenticity. Yet, the characteristics of IBF do not necessarily reflect the Quranic economic meaning of authenticity or, for that matter,

Shari’ah-based principles as formulated in the aspirational notions of IME. Instead, religion serves to provide justification for IBF’s current operations by claiming legitimacy in the form of ethicality and social responsibility as shaped by Islam. This study is exactly an attempt to prove this glide from utopia to reality and analyze this growth and judge as to how much its bideness is to its real purposes and foundations of Islamic Shariah and its compliance.

For our study we will use three randomly selected banks from three major Islamic financial hubs i.e. Pakistan, Malaysia and UAE. For this purpose we have selected MEEZAN BANK from Pakistan the leading bank of it’s industry. BANK ISLAM MALAYSIA the first ever full fledge Islamic bank of Malaysia and the EMIRATES BANK from UAE.

Lets us begin our quest and analyze first the financial performance and hence growth of these institutions for the first part/test of our study. let us see where we arrive in terms of their financial growth. however before we begin it is worth realizing that we must not lose sight of the above mentioned back ground of which has thrusted us on doing what we are about to do and to provide for answers to questions like Have Islamic financial institutions lost their social origins and become too ‘commercialised’ in pursuit of profits? Is the industry true to its ethical principles?

Well let us see!!

6.0. ANALYSIS OF FINANCIAL GROWTH OF ISLAMIC BANKS:

In the wake of meteoric growth of banking industry, Islamic banking is elevating big time. To evaluate this progress, attempt has been made to measure and analyze the performance of Islamic banks in during all this time. In this compendious analysis we have evaluated intertemporal and interbank performance of three Islamic banks (Meezan bank, Bank Islam and emirates bank) for the years 2006-2008. To actualize this objective, analysis has been made in four major areas of financial ratios i.e. profitability,

liquidity, risk and solvency and the focus on the number of branches been augmented in this time. Mean, standard deviation, has been used to test the significance of the results of the analysis. The basic source of data for this paper is annual reports of banks. This study finds out that Islamic banks have made rapid strides in terms of growth and are much more impactful as they used to be in this which is now a dual systemic world of banking.

Performance evaluation is an important pre-requisite for sustained growth and development of any situation. It is customary in banks to evaluate the pre-determined goals and objectives, with the changes goals and objectives, the criteria of evaluation of banks have undergone changes overtime (Abdul Awwal Sarker). Evaluation of bank performance is important for all stake holders: owners, Investors, debtors, creditors, government, depositors, bank managers and regulators. The performance of banks gives directions to the stake holder about their performance. For example it gives direction to the debtor and the investor to make decision that either they should invest money in bank or invest their some where else. Similarly, it flashes direction to bank managers whether to improve its deposit service or loan service or both to improve its finance. Regulator and government are also interested to know for its regulation purposes. (we must keep in mind that this performance/growth analysis is just the first part of our test the results of which will be compared to their foundational aspects of achieving MAQASID AL-SHARIAH.let us start our analysis.

6.1. Methodology and data:

The analysis of bank performance concentrates on the following on financial ratios: a. profitability; b. liquidity; c. risk and solvency; plus we will also focus on the number of branches as it will also augment the idea of the growth Islamic banks are achieving.

a)**Profitability Ratios:**

The profitability can be judged by the following criteria.

1) Return on asset (ROA) = Profit after tax/ total asset
2) Return of equity (ROE) = Profit after tax/ equity capital
3) Profit expense ratio (PER) = profit/total expense

ROA and ROE are the indicators of measuring managerial efficiency. ROA is net earning per unit of a given asset. It shows how a bank can convert its asset into net earnings. The higher ratio indicates higher ability and therefore is an indicator of better performance. Similarly, ROE is net earnings per rupee equity capital. The higher ratio is an indicator of higher managerial performance. However, profitability is only part of bank performance story. A high PER indicates that a bank is cost efficient and makes higher profit with a given expense.

b) Liquidity Ratios:

A bank's liquidity risk refers to a comparison of its liquidity needs for deposit outflows and loan increases with the actual or potential sources of liquidity from either selling an asset it holds or acquiring an additional liability. For the sample bank, this risk is approximated by comparing a proxy of the bank's liquidity needs, its deposits, with a proxy for the bank's liquidity sources and its short-term securities. Although both variables are only rough approximations (funding loans may be a major liquidity need, and purchasing liabilities may be an important source of liquidity), this relationship is a beginning indicator of most banks' liquidity risk. The trade-offs that generally exist between returns and risks are demonstrated by observing that a shift from short-term securities to long-term securities or loans raises a bank's returns but also increases its liquidity risk. The inverse would be true if short-term securities were increased. Thus, a higher liquidity ratio for the sample bank would indicate a less risky and less profitable bank. In another situation

Bank and other depository institutions share liquidity risk because transaction deposits and saving accounts can be withdrawn at any time. Thus when withdrawal exceeds new deposit significantly over a short period, banks get into liquidity trouble. There are several measures for liquidity.

1) Cash deposit ratio (CDR) = cash/deposit. Cash in a bank vault is the most liquid asset of a bank. Therefore, a higher CDR indicates that a bank is relatively more liquid than a bank which has lower CDR. Depositors' trust to bank is enhanced when a bank maintains a higher cash deposit ratio.
2) Loan deposit ratio (LDR) = Loan/deposit. A higher loan deposit ratio indicates that a bank takes more financial stress by making excessive loan. Therefore, lower loan deposit ratio is always favorable to higher loan deposit ratio.
3) Current ratio = Current asset (CA) / current liability (CL) It indicates how the bank management has been able to meet current liability i.e. demand deposit with the current asset. A high ratio is an index that shows bank has more liquid asset to pay back the trust (deposit) of the depositors. When withdrawals significantly exceed the new deposits banks usually recourse to replace this shortage of funds by selling securities. Government securities are easily sold and are considered liquid. As such the current ratio as measured above is expected to be more preferable to lower current ratio.
4) Current asset ratio (CAR) = current asset/total asset. A high CAR indicates that a bank has more liquid asset. A lower ratio is a sign for illiquidity as more of the assets are long term in nature.

c) Risk and Solvency Ratios:

A bank is solvent when the total value of its asset is greater than its liability. A bank becomes risky if it is insolvent. The following are the commonly used measures for a risk and insolvency.

1) Debt equity ratio (DER) = Debt/equity capital. Bank capital can absorb financial shock. In case asset values decrease or loans are not repaid bank capital provides protection against those loan losses. A lower DER ratio is a good sign for a bank.
2) Debt to total asset ratio (DTAR) = Debt/total asset indicates the financial strength of a bank to pay its debtor. A high DTAR indicates that a bank involves in more risky business.
3) Equity multiplier (EM) = Total assets/share capital. It is the amount of assets per rupee of equity capital. A higher EM indicates that the bank has borrowed more funds to convert into asset with the share capital. The higher value of EM indicates greater risk for a bank.
4) Loan to deposit ratio (LDR) = loans/deposit measures liquidity as well as credit risk for a bank. A high value indicates a potential source of illiquidity and insolvency.

NOTE: IN THE FOLLOWING TABLE THE (+) AND (-) SIGNS ARE SHOWING THE TREND NOT BY HOW MUCH THEY HAVE INCREASED FOR EXAMPLE A + SIGN WITH 1.87333 IS JUST SHOWING THE INCREASE IB TREND NOT THAT IT HAS INCREASED BY 1.87333.

GROWTH TRENDS OF ISLAMIC BANKS FROM 2O06-2008

TABLE 1

Performance	**Meezan bank(PAKISTAN)**	**Bank Islam Berhad(MALAYSIA)**	**Emirates bank(U**

			AE)
Measure	**Mean**	**Mean**	**Mean**
1.Profitability[increase(+)/decrease(-)]			
1.ROA	+0.90417	+0.365671	+0.7249 41
2.ROE	+0.305625	+0.0235	+0.0805 25
3.PER	+1.87333	-0.034	+0.2695 5
2.Liquidity[increase(+)/decrease(-)]			
1.CDR	+0.28O833	+0.0255	+0.0658 33
2.LDR	+1.193333	-0.01	+0.0193 43
3.CR	+0.596667	+0.635	+0.6166 7
4.CAR	+0.425833	-0.865	+0.6183 3
3.Risk and Solvency[increase(+)/decrease(-)]			
1.DER	+0.098925	-0.1088	+0.0922 5
2.DTAR	+0.0159833 3	+0.01144	+0.2645 33
3.EM	+0.21775	+0.23905	-0.0184
4.LDR	+2.384167	+0.024565	+0.0899 16
4 . Number of branches			
Branches	166	99+	110

6.2. Analysis of Empirical Results:

Means of various performance measures of three Islamic banks between 2006-2008 are shown in the Table 1. All profitability measures ROA, ROE and PER, in Table 1 indicates that Islamic banks makes progress in profitability during 2006-2008. This improved performance is statistically significant as the means of ROA ratio has increased. The increase in the returns might have been due to awareness gained but the users of Islamic banks. This is supported by the increased cash deposit and loan deposit ratios. Particularly in the case of meezan and emirates.

The second part of Table 1 shows the liquidity position of Islamic Banks for over 3 years. We see that Islamic banks performances in liquidity ratios are more or less the same however bank Islam does show a decline in LDR and CAR but the point is that the over all trend remained an increasing one!

The third important category for measuring Bank performance is risk and solvency. This ratio between 2006-2008 (Table 1) reveals that banks involvement in risky business measured in DER, DTAR, EM increased over years. The means of debt-equity ratio (DER) and equity multiplier (EM) increased by 9.8% for meezan and 21.77 for EM. In case of bank Islam DER has gown down but EM has increased by 23.905. for emirates DER has increased by 9.2 but a slight decline in EM. Other measures, like DTAR and LDR have also increased. Therefore again an overall increase in the performance of Islamic banks even in the medium of risk and solvency ratios as well. However if the comparison is made on the individual basis it is clear from the figures in table1 and from the analysis it self that meezan bank is ahead of the other two followed by emirates and bank Islam. Meezan bank even have surpassed the other two in number of branches as well.

So these performance analysis shows that these Islamic banks are going great guns and gaining some ground in terms of there progress and their growth and hence impacting the world scene even the number of branches that are multiplying at the rate of knots can alone help one to judge the pace of the growth of this sector which is an enormously encouraging sign for the good things to come. The only point now is to see that is this growth is accordingly with in the ambit of Shariah compliance and hence MAQASID AL-SHARIAH? To answer this let us now put these financially

growing Islamic banks through a MAQASID AL-SHARIAH filter and judge this growth in accordance with their real aim of Shariah compliance.

Most of the discussions by modern Muslim scholars on the objectives of Islamic banking, however, have not dwelled in depth into the theoretical framework underlying the objectives of Islamic economics, banking and finance. For example, Kamel (1997) opines that unless the impact of the implementation of IB is reflected in economic development, creation of value added factor, increased exports, less imports, job creation, rehabilitation of the incapacitated and training of capable elements, the gap between the Islamic and conventional banks would be narrower. It is also eluded that IB would strive for a just, fair and balanced society; it is community oriented and entrepreneur friendly emphasizing productivity and expansion in real economy; and it will promote brotherhood and cooperation (Dusuki, 2005) citing (Chapra, 1985, 1992; Ahmad 2000; Chapra 2000a, 2000b; Siddiqui 2001; and Naqvi 2003). Chapra (1985) has outlined the following distinctive features of Islamic banks, among others: abolition of interest, adherence to public interest, catalyst for development, promotion of economic well-being, establishment of social and economic justice, and equitable distribution of income.

7.0. The Objectives of IB Based on Maqasid al-Shari'ah Framework

As mentioned earlier in the introductory section of this paper, the IB objectives have not been formally reviewed. Hence, i have tried to derive the objectives of IB from the theory of the objectives of al-Shari'ah (Maqasid al-Shari'ah), which Muslim scholars have developed as far as the third century after Hirah, 9th Century A.D. (al-Raysuni, 1992). I will be using Mustafa Omar Mohammed, Dzuljastri Abdul Razak and Fauziah Md Taib's work on the performance measures of Islamic banks based on maqasid al-shriah framework (unpublished) as base paper for my study in this context leading to a GRID MATRIX .

Almost all the scholars of Maqasid are unanimous about the general objectives of al-Shari'ah, which are to promote welfare (Jalb al-Masalih) and avoid vices (Dar' al-Mafasid) (Ibn 'Ashur, 1998, p.190). However, some of them differ in their classification of the specific objectives inspite of some similarities. For example, Ibn 'Ashur mentions that the specific objectives of the Shari'ah should include the preservation of order, promotion of human welfare, prevention of corruption, establishment of justice and, maintaining stability and harmony (al-Risuni, 1992). Meanwhile 'Ilal al-Fasi includes in his classification objectives such as reforming the human mind, developing the earth, managing benefits for all, preserving order and system of livelihood, establishing justice and, utilizing Allah's natural resources (Ibid). A more refined form of the specific objectives of al-Shari'ah is provided by Abu Zaharah (1997). He classified them into three broad areas, namely:

1. Tahdhib al-Fard (Educating the individual)
2. Iqamah al-`Adl (Establishing justice)
3. Jalb al-Maslahah (Promoting Welfare)

This study shall adopt Ibn 'Ashur's definition of the general objectives of al-Shari'ah and Abu Zaharah's classification of specific objectives (1, 2 and 3 above) as the basis for the objectives of Islamic banking.

7.1.Research Method

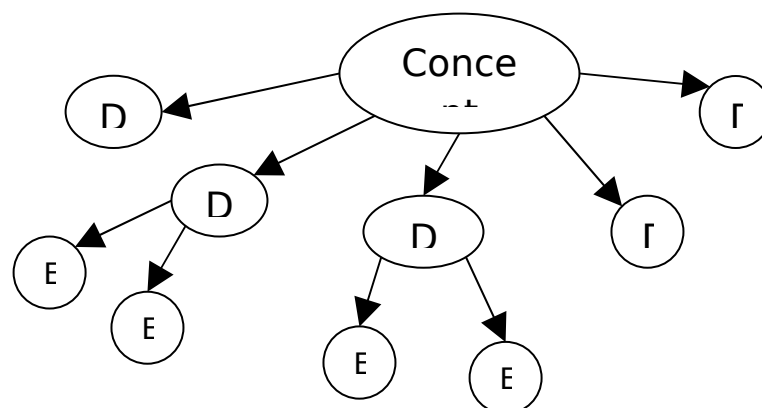
7.1.1.Introduction

As mentioned in the introductory section, the first objective of this study is to identify the ideal objectives of Islamic banking from the theory of Maqasid al-Shari'ah. This has been achieved by going through relevant literature and

Shari'ah sources. Accordingly, three broad objectives were identified, namely educating individuals, establishing justice and Maslahah.

Secondly, I will propose, IB performance measures from the three objectives identified above. I like my base paper will make use of Sekaran's method (2000, pp.176-195) to operationally define these objectives of Islamic banking into measurable items. This is done by looking at the behavioral dimensions denoted by the concept. These are then compared to the analysis and the result of the financial cum growth analysis of the concerned Islamic banks and hence their judgment of financial growth to Maqasid al-Shariah

7.1.2.Overview of Sekaran's concepts of Operationalization Method

Sekaran's method breaks down abstract notions or concepts (C) into observable characteristic behaviors, which she termed as dimensions (D). The dimensions are then further broken down into measurable behaviors that she referred to as elements (E). She cited the example of thirst as a concept. The behavior of thirsty people is to drink a lot of fluid (Dimension). The degree of thirst can be measured by the number of glasses drunk by each thirsty individual (Element). Sekaran's model can be illustrated as follows where D denotes Dimensions and E, Elements.

Operational Definition of the Objectives of Islamic Banking (IB)

Using Sekaran's method, the three (3) broad objectives of IB, namely educating individuals, establishing justice and Maslahah are operationally defined. Each of these objectives or concepts (c) are then translated into broad characteristics or dimensions (D) and finally into measurable behaviors or elements (E) as follows:

Table 2

Operationalizing the Objectives of Islamic Banking

Concepts (Objectives)	Dimensions	Elements	Performance Ratios	Sources of Data

1. Educating Individual	D1.Advancement Of Knowledge	E1.Education grant	R1. Education grant/total income	Annual Report
		E2.Research	R 2. Research expense/total expense	Annual Report
	D2. Instilling new skills and improvements	E3.training	R 3. Training Expense/total expense	Annual Report
	D3. Creating Awareness of Islamic banking	E4.Publicity	R 4. Publicity expense/total expense	Annual Report
2. Establishing Justice	D4. Fair dealings	E5. Fair Returns	R 5. profit/ total income	Annual Report
	D5.Affordable products and services	E6. Affordable price	R 6. Bad debt/ total investment	Annual Report
	D6. Elimination of injustices	E7. Interest free product	R 7. Interest free income/ total income	Annual Report

	D7. Profitability	E8. Profit ratios	R 8.Net profit/ total asset	Annual Report
3. Public Interest	D8. Redistribution of income & wealth	E9. personal income	R 9. Zakah/ Net Income	Annual Report
	D9. Investment in vital real sector	E10. Investment ratios in real sector	R 10. Investment deposit/total deposit	Annual Report

The performance Ratios (PR)

The 10 performance ratios (see Table 1 above) were chosen based on the following criteria:

- Discussion on the objectives of Islamic banking and on the dimensions and elements identified from these objectives.

- Past similar research using the same ratios for measuring performance of Islamic and conventional banks (Mahmood al-Osaymy et al., 2004, Shahul Hameed et al., 2006, Ali Khass, 1996).

- Statistical conveniences in relation to the source of data (Annual reports) and the research method (Multi Attribute Decision Making) – (Hwang and Yoon, 1981)

- Accurate possible representation of the conceptual level of Maqasid al-Shari'ah, though not necessarily exhaustible.

From the Table 2 above, four ratios, namely 1) educational grant/total income ratio, 2) research expense/total expense ratio, 3) training expense/total expense ratio and 4) publicity expense/total expense ratio are assigned as measures to the first objective of Educating Individual. Hence, the higher the budget that the bank allocates for these four indicators, the more the bank is concerned about achieving educating individuals in its program. This is also good for the bank to enhance the quality of its human resource and at the same time work towards creating informed customers about its objectives and product.

Three ratios: 1) Profit/total income ratio or interest/ total income ratio, 2) bad debt/total investment ratio and 3) interest free income/ total income ratio are identified for measuring the second objective of Establishing Justice.

High rate of the ratio of bad debt to total investment indicates widening gap in income distribution due to indebtedness. Usually the banks will end up imposing penalties or repossessing the assets or projects. Likewise, high ratio of Interest free investment to total investment contributes positively towards minimizing the income and wealth disparity, since interest basically transfers wealth from the poor to the rich. Hence the bank must ensure the kind of product they offer do not create high probabilities of default.

Lastly, three PR are selected for the third objective – Maslahah. They are 1) Net profit/total asset, 2) Zakah paid/net asset and 3) investment deposit/total deposit. High profitability shows that the bank is enjoying high financial maslahah and, high Zakah net asset Ratio shows transfer of income and

wealth to the poor and the needy, thereby helping to bridge the inequality gap. Similarly, investment deposit to total deposit ratio indicates that the bank is directly investing considerably in the real sector of the economy. Such sectors include agriculture, mining, fisheries, construction, manufacturing and small and medium scale businesses, etc. The importance of these real economic sectors has direct implications to the wider population, especially those in the rural areas and the long term capital formation of a country.

7.2. Verification of the performance Measures

The IBs performance measures developed from Maqasid al-Shari'ah framework (see Table 3)has already have captured the view of Shari'ah experts from the Middle East and Malaysia who are well versed in both the Islamic and conventional banks for verification, which was done at two levels. The first level was in the form of interview. Twelve experts in the areas of Islamic banking, Fiqh and Islamic economics were interviewed in order to triangulate the performance measures developed. Nearly all the experts, through the interview, have verified the appropriateness of the IB performance measures developed. The second level of verification was in the form of questionnaire. Sixteen experts were requested to assign weights to the components and to determine whether the performance measures are acceptable. The averages weights given by the experts are presented in table 2 below:

Table 3

Average weights for the three objectives and ten Elements given by Shari'ah experts

Objectives	Average Weight (Out of 100%)	Elements	Average Weight (Out of 100%)
O1. Education (Tahdhib al-Fard)	30	E1. Education Grants/Donations	24
		E2. Research	27
		E3. Training	26
		E4. Publicity	23
		Total	**100**
O2. Justice (Al-‘Adl)	41	E5. Fair Returns	30
		E6. Fair Price	32
		E7. Interest free product	38
		Total	**100**
O3. Welfare (Al-Maslahah)*	29	E8. Bank’s Profit Ratios	33
		E9. Personal Income Transfers	30
		E10. Investment Ratios in real sector	37
Total	**100**	**Total**	**100**

*** Maslahah includes the bank’s interest plus the public interest**

Data

In this study, as per decided a sample of the above randomly selected 3 Islamic banks is considered:

1. MEEZAN BANK (PAKISTAN)
2. BANK ISLAM (MALAYSIA)
3. EMIRATES BANK (UAE)

8.0. Testing the Performance Measures

The third objective of the study is to test the performance measures developed and verified by the experts. This has been done by evaluating the performances of the 3 sample banks at three levels:

- Performance Ratios for the 3 banks
- Rating the 3 banks based on the overall Maqasid al-Shariah matrix alongside their financial growth and whose results has already been deduced in the first part of are testing.
- Overall Rating of the 3 banks based on their Performance Indicators on both grounds.

8.1. Performance Ratios

Out of the ten performance ratios identified, the study will only use the following seven ratios to evaluate the individual performance of the sample banks. The first four ratios are related to the first Shariah objective, namely Education while the last three ratios relate to the third objective, Maslahah (see Table 3 below). The three performance ratios related to the second

Shari'ah objectives (Justice) have been omitted from this analysis due to the unavailability of sufficient data for all the 3 sample banks.

i. Education grant/total income (R_1^1)
ii. Research expense/total expense (R_1^2)
iii. Training Expense/total expense (R_1^3)
iv. Publicity expense/total expense (R_1^4)
v. Net profit/ total asset (R_3^1)
vi. Zakah/ Net Income (R_3^2)
vii. Investment deposit/total deposit (R_3^3)

8.2. Empirical Results

Performance Ratios (PR)

Table 4

Performance Ratios (PR) for 1st and 3rd Shari'ah Objectives

2006-2008

Banks	PRs of the 1st Objective Average Ratios (2006 – 2008)				PRs of the 3rd Objective Average Ratios (2006 – 2008)		
	R_1^1	R_1^2	R_1^3	R_1^4	R_3^1	R_3^2	R_3^3
Meezan bank	n/a	0.0291	0.035	0.0650	0.0139	0.0631	0.654

Bank islam	0.0139	n/a	0.061	0.0307	0.0084	n/a	0.455
Emirates	n/a	n/a	0.023	0.029	0.0112	0.0518	0.800

Performance Ratios for the 1st Objective

a) Education grant/total income (RI)

From table 3 above, the Malaysian Bank Islam (BIMB) has performed relatively better in terms of providing education grants or scholarships to the public. 13.9 percent of its net income on average is allocated for the purpose. On the other hand, Meezan bank and Emirates, there is no separate data available specifically on education grant. Recently however, some Islamic banks like BMMB Malaysia have used products such as personal financing Commodity Murabahah in the form of student loan for the same purpose, but this bank is not considered in our random sample. therefore bank Islam has surpassed the other two banks in achieving this component of first Shariah objective but As a whole the banks are lacking attention on this aspect.

b) Research expense/total expense (R2)

In terms of research Meezan bank is the only one providing for this category, the rest two are yet to cover this side it seems as figures for this ratio of both the banks are not available. Thus as a result Meezan bank leads this maqasid al-Shariah purpose leaps and bounds, but seeing the figure which is just 2.9

percent shows that not much is being done on this Shariah aspect. Putting a very lame overall picture of the three banks catering this Maqsid.

c) Training Expense/total expense (R3)

In staff training programs, Bank Islam Malaysia Bhd (BIMB) is leading the other 2 banks in the sample. BIMB has allocated on average, over 6% of its total expense for the training expense. Probably the high figure for BIMB is because of using 'Other Expenses' as a proxy for the training expense. Nevertheless, BIMB has indicated in its annual report the bank's emphasis on improving its staffs' core competencies, risk management and upgrading their skills and knowledge particularly in financial analysis. Second to BIMB is Meezan allocating over 3% of its total expense on training. Where as Emirates bank is just over 2% of its total expense to training. Again it is worth mentioning that these figures are not as high as they should be particularly when compared to the normal financial which are used to judge the rather mundane performances of these banks.

d) Publicity expense/total expense (R4)

As Table 2 shows, the Pakistani Meezan bank out performs the other two banks regarding publicity. Over six percent of its total expense goes for publicity. The two banks, namely BIMB, and Emirates spend between 2-3% of their total expense on publicity. Once again low figures than what one can expect hence lack of awareness among the society.

Performance Ratios of the 3rd Objective

i) Net Profit/total Asset (R8)

This ratio measures the profitability of the bank. Accordingly, Bank Meezan here too leads the way and has proven relatively profitable than the other banks in the sample. Its net profit represents 1.3 % of its total asset. Emirates is followed next with the figure of 1.12%. Whereas BIMB profit asset ratio is less than 1%. Again although attention is there but the real will it seems is missing as not much being done as it should be.

ii) Zakah/Net Income (R9)

Once again, Meezan leads the others in terms of its zakah contribution, which is slightly above 6% of its net income. Other two banks, of which Emirates is ever so slightly behind Meezan in its zakah distribution with 5.18% of its net income however BIMB's figures are not available. In a nut shall the best deliverance seems to be in this aspect of maqasid.

iii) Investment deposits/total deposit (R10)

iv) This ratio measures the extent to which the Islamic bank contributes its investment to the real sector. Hence, over 80% of Emirates bank's total deposit is for investment purposes. The remaining two banks: Meezan bank and BIMB have over 65% and 45% of their deposits for investments respectively. Whereas the liability side of these banks is represented by a large proportion of investment deposit one expects their contribution to the real sector on the asset side to be enormous too. But unfortunately this is not the case. Most of these investment deposits are used to finance debt related activities such as the purchase of assets and investment in securities. Accordingly debt financing using al-Bay' Bithamanin Ajil, al-Murabahah, al-Salam and al-Istisna modes represent on average over 80% of their investment activities. While equity based modes represent only4 % on average. Similarly, investment in sectors like agriculture, mining, fishing

represent an average of 10 % of the total asset. Therefore, as far as this Shariah objective is concerned, more needs to be done.

It seems from our Shariah compliance test that although not much attention is been given to all these Shariah aspects which actually should be the real aim of an Islamic bank, but nevertheless from our conclusion it seems that Meezan bank is better than the other banks in comparison even in our Shariah compliance test as it was in our first test of financial growth analysis. Having said that now let us put all these results of all these randomly selected three banks into our FINANCIAL GROWTH TO MAQASID AL-SHARIAH MATRIX and judge for ourselves the ratings these banks come up with in terms of fulfilling the MAQASID AL-SHARIAH.

9. THE FINANCIAL GROWTH TO MAQASID AL-SHARIAH GRID MATRIX

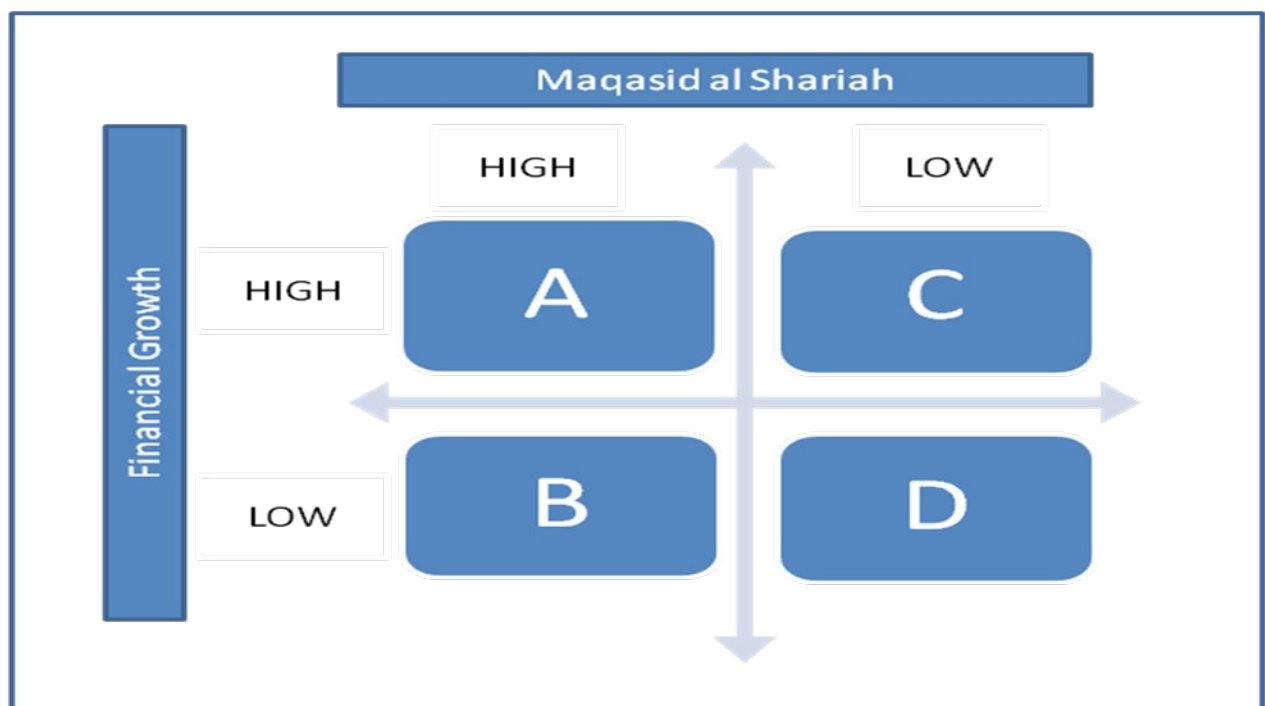
9.1. HOW THE MATRIX WORKS:

The matrix is designed based on blend of two variables THE MAQASID AL-SHARIAH and THE FINANCIAL GROWTH of the concerned Islamic banks. Based on our results from our above studies on the financial performances of the Islamic banks and in doing so their fulfillment of their foundational aspect of maqasid al-Shariah we will now rate the banks accordingly to their performances on both aspects and a combination of those result will put the bank under consideration into the category of A or B or C or D for that matter.

Grid A is a combined relation of simultaneous performances of financial growth along side maqasid al-Shariah. The grid interprets HIGH FINACIAL GROWTH ALONG SIDE HIGH SHARIAH COMPLIANCE/MAQASID AL-SHARIAH.

GRID B: Illustrates the category of banks who although possess HIGH FINANCIAL GROWTH BUT WITH LOW SHARIAH COMPLIANCE, hence low deliverance to maqasid al-Shariah.

GRID C: represents the combination of LOW FINANCIAL GROWTH BUT GOES HIGH ON THE MAQASID AL-SHARIAH ASPECT ALONG SIDE.

GRID D: Is LOW FINANCIAL GROWTH WITH LOW MQASID AL-SHARIAH! A dead end for any Islamic bank.

Now once we have under stood that how this FGMS GRID MATRIX works and is interpreted, let us now categorize and rate our banks accordingly on the basis of their financial growth verses their Shariah compliance.

9.2. RATING OF BANKS

CASE OF MEEZAN BANK:

Meezan bank the largest and the most influential of the Pakistani Islamic banks, actually the pioneer of Islamic banking in Pakistan is leading both banks in not only the over all financial growth but also in the all important and foundational aspect of maqasid al-Shariah therefore it should belong to grid A, with high financial growth and simultaneously high achievability of Maqasid al-Shariah.

MEEZAN BANK RATING “A”

CASE OF EMIRATES BANK:

Emirates bank representing UAE is one of the leading Islamic banks in the Arab country but has a different story as per our results on both grounds. It although shows low financial growth when compared particularly to Meezan bank but shows high Shariah compliance in the given period of 2006-2008,although not as high as Meezan thus it belongs to grid B with relatively low financial growth but considerable Shariah compliance respectively.

EMIRATES BANK RATING “B”

CASE OF BANK ISLAM:

Bank Islam on the other hand has shown some relatively good financial progress over these years and it has also increased in number of branches as well, though its financial growth when compared to other two is in between both but when it comes to Shariah compliance and achieving Maqasid al-shariah it is some how lagging behind the two categorizing it to belong to GRID C with relatively high financial growth but low Shariah compliance in the same time.

BANK ISLAM RATING “C”

9.3. THE OVERALL RATING OF THE BANKS:

Growth for Islamic banks in important and is the need of the hour from our exhaustive and meticulous studies above it has been proven that these Islamic banks are gaining some good ground particularly in these recent years but we must also keep a check as to how much this progress is in compatibility with their foundational merits and basis of achieving human falah through fulfilling Maqasid al-shariah.our study above has tested all these banks on both grounds simultaneously and hence compared their performances. It has thus been substantiated that banks have shown some encouraging growth in the financial pragma but not so overvehleming when it comes to achieving their Maqasid al-shariah as can be judged from the figures provided in the respective tables and hence the analysis. So overall it can be said that Islamic banks are financially growing but this growth is not as compatible and not as strongly driven by Shariah compliance and Maqasid al-shariah as it should be. Thus the over all rating of these sample banks as per our FGMS GRID MATRIX is “C”. High/rapid financial growth but not as high/rapid fulfillment of Maqasid al-shariah as there should.

THE OVERALL RATING OF THESE BANKS IS “C”

10. Conclusion

The greatest significance of this study is that it proposes the objectives of Islamic banks from the Maqasid al-Shari’ah perspective. It has tried to prove a gap in the growth of Islamic banks in terms of their financial progress and how much is it driven by their foundational merits of Maqasid al-shariah. Not only this It has also suggested a methodology that could be used to develop IB performance measures based on the Shari’ah framework by introducing a FGMS-financial growth to maqasid al-shariah GRID MATRIX to rate the banks as per their performances on the two grounds alongside. The result of the study has shown variations in the performances of the selected Islamic banks they are much more inconsistent and jittery when it comes to the seven Shariah compliance performance measures unlike on their financial growth. The study as not only rated the banks individually on both grounds but also

as given an overall combined rating of banks too. As per our ratings such variations show inconsistency on the part of the individual Islamic banks to focus on the overall Shari'ah objectives. This discussion however should not in any way be considered to undermine the progress of Islamic Banks, as its contribution in terms of bringing economic growth through expansion of the financial base in Islamic commercial banking is self-evidenced with the developments in the sector. Also, provision of alterative products in compliance with Shari'ah overcomes financial exclusion. However, against this 'commercial' nature, social aspects of IB-Islamic banks, in terms of economic development need to be addressed, which constitutes the gap between promised expectations and performance.

It can, therefore, be suggested from our results that IBs has failed to internalise the social dimension and social justice into its own operational function, as the distinguishing characteristics of IBs has been reduced to a technicality in which the value system is referred to only in describing the Quranic prohibition of riba. As a consequence, a solution to overcome social failure requires new models of institutional developments beyond commercial IBs, by going back to the Islamic construction. In this new modelling or reorienting social banking, community banking, ethical and social investment, community development-oriented projects and microfinance have to be endogenised and addressed as objectives.

In reorienting towards social banking, Professor Mahmoud El-Gamal, a renowned contributor to academic discourse in the field, in his recent books states that 'the "Islamic" in "Islamic finance" should relate to the social and economic ends of financial transactions, rather than the contract mechanics through which financial ends are achieved'.

This study has come at an opportune time for Islamic banks to revisit their objectives after three decades in operation. Since this is an exploratory

study, hopefully future research will take it as a point of departure for developing further the objectives and performance measures of IB based on Shari'ah framework and the fulfillment of maqsid al-shariah in achieving human falah. Thus, a move towards goals and policy rather than the mechanistic and legal structure of IBs will serve human well-being much better, as suggested by Professor Nejatullah Siddiqi, a leading scholar in the field. This will help to establish optimality between venal behaviour and sacrificial behaviour, and the choice between the two will be determined by the values of the participants in the sector and the interest of the larger environment. However, Islamic social and community banking can provide this balance, and the new brand in compliance with ethical religious norms regarding economic and financial activity for achieving prosperity (falah) in this world and in hereafter through purification and perfection of individuals and institutions for growth and development, the real motive of maqasid al-shariah.

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